



Culture Management in Mergers and Acquisitions

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to make integration strategies work

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to make integration strategies work.*

This article expands on my address to the Telecom Finance Conference in London, *Creating Value Through M&A*. I was invited to speak to the attendees on the subject of managing cultural transition issues in M&As (mergers and acquisitions) and joint venture situations, with particular focus on maximising deal value whilst:

- Meeting multiple stakeholder expectations;
- Managing the impact of ego-led acquisitions and unrealistic coalitions; and
- Minimising declining productivity, performance, and morale during times of change.

In my address I stressed the importance of developing an integration plan that directly confronts cultural factors, as they can be deal killers, regardless how carefully the financial and operational aspects of the deal are managed.

As my fellow speakers, leaders, and dealmakers confirmed, management in the acquiring company is often unprepared to deal with the post-merger dynamics and politics that can lead to reduced revenue, increased cost, or unmanaged risk. Underestimation and/or lack of consideration of the people or cultural integration challenges and the impact of varying leadership styles are some of the factors that can erode expected "deal value". Any resulting loss of customers and revenues can actually negate the anticipated benefits of the consolidated organisation.

Framing the Discussion

The legal, financial and operational aspects of M&As and joint ventures traditionally receive the greatest attention, but executives who have been through the merger process are beginning to recognise that managing the cultural and human side of change is critical to maximising deal value.

It seems a day doesn't go by without an announcement in the news of one high profile amalgamation or another. The merger bug has bitten private and public sector organisations of all sizes. Regardless of the size or the finances of the companies involved, the rush to "do the deal" can result in costly mistakes that surface months after the final papers have been signed.

The prevailing view here and abroad is that scale is important, that in the global marketplace bigger is better. Companies have various strategic options available to them in order to achieve their growth objectives and to compete effectively in the global marketplace. The first key decision they must make is whether to grow incrementally or to take a giant leap forward. Incremental growth options include introducing new products or services, enhancing existing services to grow top-line revenue, and entering into new markets. If the company prefers to take bigger steps in terms of growth (the 'leap forward' approach), M&A is perhaps the quickest way to increase its presence in the marketplace.

Regardless of the growth strategy decided upon, success will be measured not by what you do to grow, but by how well you do it. Although the impact of a major merger or acquisition is what led to its appeal as a growth strategy in the 1990s, M&A is the riskiest method of achieving growth objectives.

There is compelling evidence to suggest that growth through M&A is not, in itself, a guarantee of success and that historically many deals failed to deliver their estimated returns. Dealmakers are now being forced to better manage investment expectations. Over the past few years, Square Peg has seen increasing evidence that good managers are making calculated decisions and placing bets on organisations based on a disciplined approach that allows them to make well informed and commercially successful choices. The margins of error in integration efficiency and deal effectiveness that were acceptable only a few years ago, are no longer tolerated in a market run by sophisticated managers who cut their teeth on deals, turnarounds, and integrations as junior consultants, and who quickly came to understand the difference between political posturing and sustainable value creation. Managers of this type represent Square Peg's key client base. They possess the power and resources to make a difference; have the seniority, experience and insight to guide significant change; and appreciate our frank approach.

Does Culture Matter in M&As?

It most certainly does! Culture and people issues have been cited as the most common factors for M&A failure in six major studies. The research has shown that 70% of mergers and acquisitions fail to achieve their anticipated synergies, and 50% suffer an overall drop-off in productivity in the first four to eight months. "People problems" were cited as the top integration failure factor in a sample of 45 CFOs from Fortune 500 companies that had recently merged or acquired.¹

The stock market has become merciless in its treatment of M&As. When a merger or acquisition is announced, the value of the acquired company's stock typically increases. But the same cannot always be said for the stock value of the acquiring organisation, which rises in only 30% of cases. Analysts and investors expect the merged enterprise to be greater than the sum of its parts – in essence, that one plus one will equal three. These same analysts and investors are content to sit on the sidelines and wait for management to deliver the synergies that will be essential for the financial success of the deal. It is these projected synergies that are the real value of the deal.

Maximising Deal Value

The 'deal flow' in M&A can be viewed as a chain with five distinct links:



The "formulate", "locate" and "investigate" stages occur before the deal is made and are referred to, collectively, as the "pre-deal" phase. During these stages, the acquiring company sets out its

¹ Sources: CFO Magazine, Business Week, Fortune

growth objectives and its acquisition strategy². Target companies are identified and assessed for potential fit into the growth objectives, and then the due diligence is conducted. The goal during the pre-deal phase is to forecast, as accurately as possible, the potential value of both the financial and human capital that would be realised if the deal is consummated.

As the organisation moves through the pre-deal phase, the due diligence becomes a particularly important task and must be considered from two perspectives. The first is financial, where "deal breakers" are most likely to arise. In terms of human resources, the financial perspective includes such matters as the funding of pension plans, plan structures, and risks and liabilities that may be associated with workers compensation, collective agreement provisions and employment-related litigation. The variations in legal, accounting and reporting practices that exist from country to country have increased the complexity of conducting thorough financial due diligence. Inaccurate estimates of financial liabilities for pensions or retiree medical benefits can potentially eliminate any financial gain from the transaction.

Due diligence must also be undertaken from the human capital perspective, for if it is neglected during the pre-deal phase, it can minimise the value of the deal. During human capital due diligence, the acquirer should seek to identify commonalities and differences in such areas as partner/target company culture, leadership models, organisation structure, performance management systems and workforce development approaches. While it is unlikely that human capital due diligence will unearth "deal breakers", it will provide the acquirer with critical insight into the potential cost of realising deal value. In situations where a high degree of integration is desired, a thorough human capital due diligence will allow both partners to properly assess its true cost.

Although due diligence should be a mechanical exercise, we find that the emotion and momentum of the deal often obscures its results. Thus, while lawyers, investment bankers and various other advisers representing the acquirer and the target meet to make the deal in the "negotiate" phase, their council regarding areas of risk is often ignored by key decision makers in the two companies. In essence, the parties are agreeing on the potential value while ignoring some of the key data. Once the deal has been concluded, and the value in terms of hard assets and intellectual capital has been identified and agreed to, the focus shifts to the various functions within the two organisations - operations, finance, marketing, sales and human resources - to make the deal happen.

In the post-deal integration phase, the perceived value of a merger or acquisition will either be realised or not. Unfortunately, for many companies, it is in this phase that the deal fails. This occurs when the parties focus too much on the financial aspects of the merger or acquisition without adequately addressing how the people of two or more organisations will be integrated into one cohesive entity. A proven method to maximise deal value is to embrace the integration process as a far-reaching change-management initiative for both companies. Enterprise-wide integration is applied simultaneously with speed and rigour to all functional departments and business units in a merger. It relies upon disciplined project management, process consulting and tactical problem-solving to achieve a fast and effective merging of the business processes, systems and organisational issues. A single infrastructure is used to co-ordinate all integration efforts and communications across the combined companies.

This disciplined enterprise-wide approach to merger integration helps organisations maximise deal value by focusing on generating the following benefits:

² *Watson Wyatt Worldwide – FLINI integration model*

1. Achieving the deal synergies promised to investors;
2. Merging both organisations and their respective business processes as quickly as possible;
3. Ensuring the retention of key employees and customers;
4. Avoiding the costly mistakes that can occur in merger integration;
5. Communicating strategically with all managers and employees; and
6. Measuring operating results and employee perceptions on an ongoing basis.

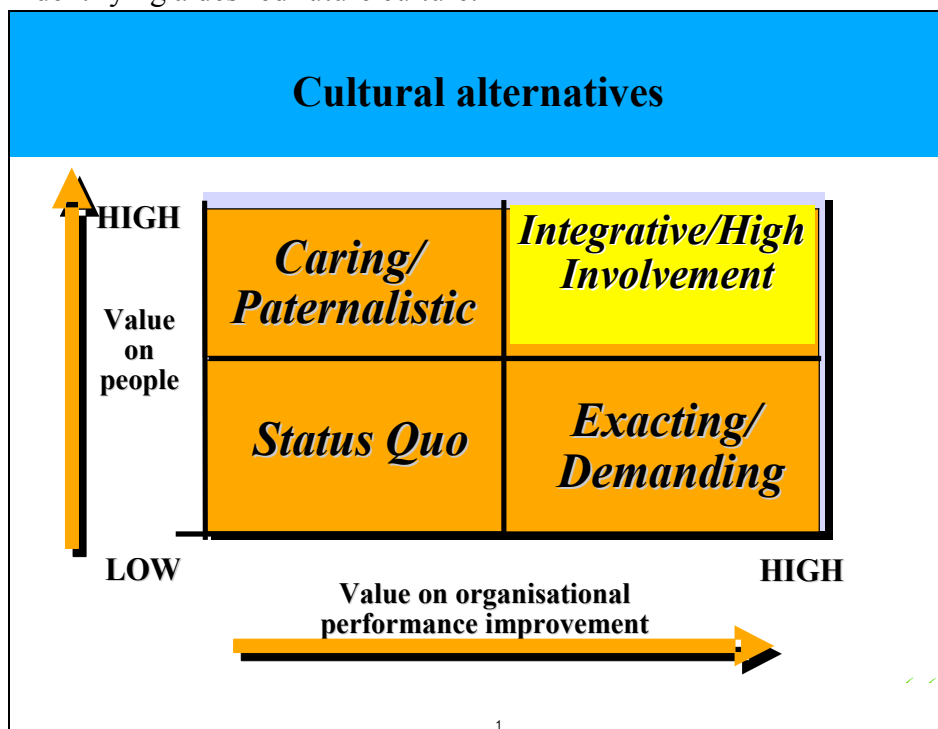
An aggressive merger integration timeline for the three phases of M&A is a necessity from the outset:

1. The "pre-deal" phase (before the announcement of the merger);
2. The "deal" phase (within 60 days after the deal is closed); and
3. The "integration" phase (subsequent to the first 60 days).

What Are We Trying To Achieve In Integration?

The objective is to obtain support from one hundred percent of the change leaders and officers to champion the integration process. During the integration, the degree to which employees keep focused on running the business and on continuing to deliver seamless service to customers will be a result of timely communications that address issues about their own position in the "new" organisation. While it will take some time to determine if all of the long-term objectives of the merger have been met, speed of integration will help to capture estimated pre-consolidation synergies and keep the new company on track to achieve first-year financial objectives.

Although much of the change leader's role will involve details of integrating tactical components of the structure and plan, it is strongly recommended that the desired culture, vision and values be reflected in all decisions and communications. The strategic framework (Fig.1) illustrates some alternatives in identifying a desired future culture.



(Figure 1)

Outlined below are brief examples of the implications of reinforcing one culture or another in this simplified model:

- **Caring/Paternalistic:** Family oriented; effort and activity are rewarded; "fitting in" is important; typically slow to change; a trusting environment.
- **Exacting/Demanding:** Emphasis on the bottom line; "eat what you kill"; focus on efficiency, competition, and individual performance; up or out learning environment.
- **Status Quo:** Often reflects apathy; elicits comments such as, "we have always done it that way", "seniority wins", "procedures are important", "we play by the rules".
- **Integrative/High involvement:** Fosters co-operation, risk-taking and group performance; a true learning organisation; strong communications and feedback; open book; team oriented.

Throughout the transition from one culture to another, we find that if organisations cannot be explicit about how they want their culture to be aligned with their commercial strategy, then conflicts and confusing messages end up being sent to both their employees and their customers.

Now That We Have Defined the Culture, What's Next?

The move to a new culture is a not simply a new programme, new set of reports, or new training. It is most often a significant change initiative fraught with all the perils of workplace change.

Once the organisation knows what it wants to be, aligning its systems, processes and procedures to reinforce the desired culture is critical. These mechanical adjustments are the easy part; the difficult part is aligning the employees and leadership team with the new culture. Once the culture is defined it is important to:

1. Obtain individual buy-in from leaders
2. Address the "me" issues
3. Identify integration risk factors
4. Avoid deadly sins of M&A's
5. Learn from best practices

1. Obtain Individual Buy-In From Leaders

Integration strategies must first be consistently understood and owned by the leaders to be effectively implemented. Square Peg's experience is that this is often not the case in the immediate post-integration period. To succeed, leaders must have a vehicle for articulating their basic assumptions, expectations and values, and consciously assess what they need to change *personally* before engaging others in the organisation. We have found that the process of aligning leaders with a new strategy and culture works best if a step by step approach is taken:

Interpretation: The amount of cohesion between each leader's unique interpretation of the desired culture, climate and post integration strategy. Leaders must understand the pressing commercial "business case" for change.

Acceptance: The degree to which leaders accept the integration change plan as the "best" one under the circumstances will highly influence the success of implementation.

Commitment: The level to which the leaders accept the strategic and cultural change goals as being in line with their personal goals will be a function of the degree to which they perceive the change to be a personal threat or an opportunity for development.

Competence: The competence of the organisation and its leaders, in terms of skills, abilities, systems and infrastructure, to achieve the changes required to make the culture and integration strategy work will provide barriers or enablers for successful implementation.

Successful change can be attributed, at least in part, to the early realisation that the merger integration needs to be managed as a fully co-ordinated plan, including:

- An early start;
- A timetable aimed at speedy completion;
- Decisive leadership;
- Clear and frequent communications to members of both organisations; and
- Focus on customer service, and the willingness to make decisions on the toughest issues.

The stakes are high whenever mergers and acquisitions take place. Our experience is that a well-managed, enterprise-wide integration process that recognises change management concepts can significantly enhance the launch of a newly amalgamated organisation.

2. Address the "me" Issues

One of the most critical priorities for the management of merging organisations is to address the "me" issues. During mergers or acquisitions, "me" issues will preoccupy employees at all levels within both organisations. Typical "me" issues include:

- Will I have a job?
- Will my pay and benefits change?
- What will happen to my pension plan?
- Who will I report to?
- Will I have to move?
- What will 'they' be like to work for?

Employee concern about "me" issues creates an inward focus away from customers. Service suffers as a consequence and employee productivity drops off. The new enterprise could also lose key talent as employees search for an environment with less uncertainty, an outcome that would be

particularly detrimental for an organisation that was buying specific knowledge or competence as a goal of the acquisition.

Because senior management's "me" issues will usually be answered before the majority of employees, they must consciously manage employees from where the organisation 'is', and not from where they 'are' as a management team. Senior management must guard against the temptation to focus on the "next deal" while employees are thinking of issues posed by the current deal. Management can influence how long productivity drops off for as a function of the change management process and the speed with which it is applied. Prolonging the integration process will only serve to extend the drop in productivity and delay the realisation of deal value.

3. Identify Integration Risk Factors

To increase the probability of a successful merger or acquisition, Square Peg has identified 12 integration risk factors that should be taken into account from the first stages of planning by senior management. The nature of the risk, and the extent to which each factor applies, will need to be assessed on a deal-by-deal basis. Where possible, a mitigation strategy should also be developed to help the enterprise manage the risk. We have framed these risk factors in the form of questions that may be on the minds of investors, analysts or stakeholders in the M&A process.

Pre-deal positioning: What potential synergies were identified to legitimise the deal and why was the deal initiated in the first place?

M&A capability: What is the experience with M&A? The extent to which the enterprise is experienced with M&A will serve to mitigate risk.

Proximity: Are the organisations in different geographical regions? If so, to what extent will the legal, language and cultural differences associated with integrating organisations from different geographical areas lead to increased risk?

Hostility quotient: What are the circumstances surrounding the merger? Generally, as the degree of hostility towards the acquiring organisation increases, so does the risk.

Competition: What is the nature of the competition the company faces? Organisations operating in highly competitive markets will be under increased pressure to achieve deal synergies. Competitors will move quickly to fill the gap created by organisations in pause.

Financial context/business performance: What is the degree of confidence that a struggling target can be turned around? How long will it take?

Relative dominance: One of the myths within M&A is the "merger of equals". Have the organisations been honest internally? The extent to which this remains unresolved will contribute to increasing risk.

Strategic non-alignment: To what degree will organisations that are not strategically aligned be integrated and how will the integration effort affect the level of risk?

Desired integration level: To what extent will the organisation be integrated? Full integration can increase the complexity of the deal and the associated risk.

Management talent: Does the management team have the necessary talent to lead the new enterprise through the integration?

Ambiguity in power and authority: Who is "in charge?" Is the company building M&A as a core competency? The integration process must be driven internally as a priority for senior management. The appointment of an experienced and respected manager to lead the integration process is a key to mitigating risk.

Concurrent pressures: To what degree is the organisation facing other internal or external pressures? There is a limit to the number of fires that management can reasonably be expected to fight successfully at any one time.

Senior management should continually assess and review the issues around each of these risk factors. The advantage of using enterprise-wide integration as an approach to M&A is that the actions designed to mitigate risk can be incorporated into project planning and monitored on a company-wide basis throughout the integration process.

4. Avoid the Seven Deadly Sins of M&A's

While there are undoubtedly roads to success in mergers and acquisitions, there are a few "sins" that if committed, will guarantee deal failure.

1. **Poor due diligence including financial and human capital due diligence.** The former will result in money being left on the table. The latter will lead to unanticipated integration costs.
2. **Delaying the start of the integration and dragging out the finish.** The longer integration is allowed to drag and issues are left unresolved, the longer productivity will suffer and the longer it will take for synergies to be realised.
3. **Allowing divergent initiatives.** Integration can be viewed as a race, in which the objective is to have everyone cross the finish line together. By allowing divergent initiatives, you will delay crossing that line.
4. **Taking too long to answer the "me" issues.** Remember that in an M&A situation, you should expect a drop in productivity while employees search for answers to the questions that are important to them. Both the duration and the magnitude of the drop are within your control.
5. **Insufficient communication.** During an M&A, people's desire to "know" increases. If you do not communicate enough, you will effectively create an information void that will be quickly filled with rumour and innuendo further affecting productivity.
6. **Putting no one in charge.** Like many sports teams, the M&A team needs a "go-to person" that can make things happen. The project leader must be someone who is respected in the organisation and who has the authority to make decisions.
7. **Ignoring project management disciplines.** This is perhaps the deadliest sin of all. Your organisation is about to embark on a major project with another company that you don't

even know. Disciplined project management is the only way to ensure that you can plan, monitor and measure your progress to achieve the goals you set at the beginning of the process.

5. Learn from Best Practices of M&As

The following are 10 key M&A success factors that will ensure deal value is maximised:

1. **Perform thorough due diligence, both financial and human capital.** Whatever happens at due diligence will impede or facilitate the post-deal activities; ensure you have a sceptic on your team.
2. **Formulate the vision of the degree of integration.** The degree dictates the complexity and its associated risks.
3. **Increase the speed of decision making.** This is not the occasion for precision.
4. **Align senior management.** Visible support and commitment is mandatory.
5. **Clearly define the approach.** Everyone who needs to know, knows.
6. **Appoint a respected and capable integration leader.** This is not the time to earn stripes; this is the time to use them.
7. **Establish a dedicated and capable merger team.** Team and task members must be responsive and focused.
8. **Utilise best practices.** Use the best available to you.
9. **Set measurable goals and objectives.** Clear and achievable deliverables are a must.
10. **Maximise communication.** Open and frank two-way communication is an imperative.

The goal of our discussion at the Telecom Finance Conference was not to provide the attendees with all the answers to be successful in the M&A arena. Rather, the intention was to focus on the point where the real value of the deal is realised and to provide our thoughts about maximising deal value.

We have found that cultural incompatibility is one of the biggest problem facing clients when managing a merger acquisition or joint venture. Yet it is these same clients who typically underrate the need for due diligence and the impact this insight can have on organisational culture and the dynamics of change. We understand that the time to make change is limited; that the way in which cultural integration is handled will make the difference between success and failure of the deal; and that delaying the start of integration and dragging out its completion is one of the worst of the deadly sins. These key lessons are nicely summarised by Jack Welch in his book, *Straight from The Gut*:

“I’ve learned in a hundred ways that I rarely regretted acting but often regretted not acting fast enough.”

ABOUT THE AUTHOR

Douglas D. Ross is Managing Director of Square Peg International and specialises in the people side of change, focusing on mergers, acquisitions, joint ventures and cultural alignment. He retired his partnership in the Human Capital Group at Watson Wyatt PLC in 2004 following a decade supporting clients in 20 different countries, many in the throes of post-merger integration.

He is recognised for a dynamic and practical consulting approach that has evolved during a career that has included executive management, theatre production, military and manufacturing management assignments. He has been honoured by the Canadian Government for his leadership work and in December 2002 was identified by the Independent Newspaper as one of the top 10 management consultants in the UK.

His practical experience in Mergers and Acquisitions, Joint Ventures and organisational change, combined with his educational credentials including MBA, Certified Management Consultant (CMC), Visiting Fellow at Kingston University and Associate Professor of Marketing Strategy at the Canadian School of Management, and his position as past Global Chairman of the Strategic Leadership Forum, qualify him to assist clients to align their people practices and processes with their merger strategies.

ABOUT SQUARE PEG INTERNATIONAL LTD.

Square Peg is a consulting practice that provides an integrating force in the alignment and effectiveness of organisations. Its services are based on the interrelationship between business strategy, leadership and human resources; its focus is to help clients improve performance and drive value.

As business consultants focused on the people side of change, Square Peg supports clients managing a variety of enterprise-wide issues such as M&A's, establishing new mandates, and meeting new expectations.

From offices in the UK and North America, Square Peg International Ltd. assists companies to capture the full value of their investment in people.



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